

Service Date: August 24, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of)	
the CITY OF RONAN for Authority to)	UTILITY DIVISION
Increase Rates and Charges for Water)	DOCKET NO. 88.5.9
Service in its Ronan, Montana Service)	ORDER NO. 5356
Area.)	

APPEARANCES

FOR THE APPLICANT:

Richard Gebhardt, Attorney at Law, E. 308 17th Avenue #B,
Spokane, Washington 99203.

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34
West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Geralyn Driscoll, Staff Attorney, 2701 Prospect Avenue,
Helena, Montana 59620.

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena,
Montana 59620.

BEFORE:

Howard Ellis, Commissioner and Hearing Examiner

BACKGROUND

1. On May 4, 1988, the City of Ronan (Applicant or City)
applied to this Commission for authority to increase rates and

charges for water service to its customers in its Ronan, Montana service area. The Applicant requested an average increase of approximately 114%, which constitutes an increase of approximately \$98,013 in annual revenues.

2. On August 4, 1988, following issuance of proper notice a hearing was held in the City Courtroom at Ronan. For the convenience of the consuming public there was a night session at the same location. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment. At the close of the public hearing, all parties stipulated to the issuance of a final order in this docket.

ANALYSIS AND FINDINGS OF FACT

3. At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

Thomas Hansen, Consulting Engineer
Carlene Bockman, City Clerk
M. Harry Wheelan, City Foreman

These witnesses testified on the need for the proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of proposed capital improvements, debt service obligations, and rate structure.

4. During the hearing the Montana Consumer Counsel presented the testimony of 3 public witnesses. The public witnesses expressed their support of the City's proposed capital improvement program

and financing proposal. One witnesses, while expressing support for the capital improvement program, did offer a warning regarding the impact that the proposed rate increase would have on fixed-income consumers.

CAPITAL IMPROVEMENT PROGRAM

5. In its application Ronan has set forth a proposed capital improvement program for the water utility. The total estimated cost of the capital improvements as outlined by the Town is \$1,962,000. The following Table 1, sets out the proposed costs associated with the capital improvements program.

TABLE 1

1. Supply Disinfection	\$ 69,000
2. 750,000 Gallon Storage	\$280,000
3. Transmission Lines	\$291,600
4. Distribution Improvements	\$860,000
5. Engineering	\$122,000
6. Miscellaneous	<u>\$339,400</u>
Total	\$1,962,000

6. Ronan proposes that construction of the capital improvements under consideration in this Docket be funded by a loan and a grant from the Farmers Home Administration (FHA). FHA has committed to loaning the City \$1,100,000 for construction of the capital improvements and also has authorized a construction grant in the amount of \$820,000.

The FHA loan proceeds would be funds that require repayment by water utility subscribers. The grant funding would not require repayment and therefore, has no impact on the rates assessed water utility customers.

7. The City's proposed water system improvement program, as testified to by the City's witnesses, includes the replacement of existing deteriorated undersized mains, looping of distribution lines, replacement of inoperable valves and unreliable hydrants throughout the system, and construction of a 750,000 gallon storage tank. Improvements will be made to the water supply to provide adequate supply disinfection, that meets water quality standards.

8. The Applicant's witnesses testified that significant problems are being experienced with the water utility's existing facilities. Some of the distribution system deficiencies identified by the witnesses include: undersized pipelines that provide inadequate fire flows, excessive amounts of lost and unaccounted for water, inadequate pressures, increasing number of pipeline breaks on the system not confined to a specific area, and deteriorated water valves.

The City's witnesses indicated that the existing surface supply source, on which the City wants to provide treatment, is in violation of the Safe Drinking Water Act. As evidence, for the need to provide treatment of its surface source of supply and the violation of the Safe Drinking standards, the City pointed to the fact that the Montana Department of Health has issued a boil order for all water users east of town.

9. The Commission finds, based upon the testimony in this Docket, that the capital improvement program as proposed by Ronan is reasonably prudent and therefore accepts Ronan's assertion that the improvements outlined in the filing need to be constructed.

DEBT SERVICE

10. Ronan proposes to finance the bulk of the capital improvements outlined in this proceeding through the issuance of \$1,100,000 in revenue bonds. The proposed revenue bonds will be purchased by FHA, with repayment over a 40 year term and carry an interest rate of 5.0%.

11. In any sale of municipal bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security, the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bond's principal and interest as they come due. In this instance, the City proposes to include covenants agreeing to the establishment of a bond reserve fund in an amount equal to one year's principal and interest payment on the bonds, amounting to \$66,000, which will be accumulated over a ten (10) year period and provide a coverage ratio of 110%.

12. The Commission finds the bond covenants, establishment of a reserve fund, and the 110% coverage ratio, to be among the standard requirements for the issuance of revenue bonds and, therefore, accepts the requirements.

13. The Commission finds the issuance of \$1,100,000 in revenue bonds with a maximum term of 40 years and an interest rate of 5.0%, with the requirements that the City establish a bond reserve in an amount equal to one year's principal and interest payment on the bonds and provide a debt service coverage of 110%, is appropriate.

14. When the City completes the sale of the proposed revenue bonds it will incur an annual principal and interest payment on the outstanding revenue bonds of approximately \$66,000. It will also incur the obligation to have a net operating income of at least \$6,600 to meet the requirement that it achieve a 110% coverage ratio. The required net operating income is calculated by multiplying the principal and interest payment on outstanding bonds by 10% ($\$66,000 \times .10 = \$6,600$).

OPERATION AND MAINTENANCE EXPENSE

15. The test year operation and maintenance expenses totalling \$107,000 were not challenged by any party participating in this proceeding. The test year operation and maintenance expenses presented by the Applicant are accepted by the Commission.

16. The Commission finds the following test year operating revenue deductions to be reasonable:

Operating Expense	\$107,000
Debt Service	\$66,000
Debt Service Coverage	<u>\$ 6,600</u>
TOTAL	\$179,600

The test year expense assumes full annualized costs for the proposed revenue bond issue. The Commission chooses to calculate expenses in this manner, as it is the most reasonable way of accounting for the effect of the proposed bond issue on the operating statement of the utility.

REVENUE NEED

17. Ronan indicated that under present rates annual revenue generation would be approximately \$83,000. The Applicant also indicated that the water utility would generate \$3,000 in interest earnings, resulting in total operating revenues of \$86,000. The test period operating revenues were not a contested issue in this case and are accepted by the Commission.

18. The Commission, based upon the Findings of Fact contained herein, finds that the Applicant should be allowed to increase revenues by \$93,600. This requirement is calculated as follows:

Operating Revenue	\$86,000
LESS:	
Operating Expense	\$107,000
Debt Service	\$66,000

Debt Service Coverage	<u>\$ 6,600</u>
Total Revenue Requirement	\$179,600
REVENUE DEFICIENCY	\$93,600

RATE DESIGN

19. As part of its agreement to purchase Ronan's proposed revenue bond, the FHA will impose a requirement that Ronan's water system be fully metered. In anticipation of that requirement Ronan in this proceeding provided the Commission with a proposed metered water rate structure. The consumption information provided the Commission for purposes of establishing the metered rates is an estimated figure, because, for the most part Ronan presently provides water service on an unmetered basis.

20. While the Applicant's calculated consumption may be a reasonable estimate of the actual consumptions that will be experienced by the water utility, the Commission finds that the estimate should not be used for purposes of determining metered rates. Critical in the calculation of the applicable usage rate is actual water consumption information, because absent this actual information the reliability of the calculated rate is suspect, and could result in an over-collection or under-collection of the revenue requirement, to the detriment of the consumer or the utility, respectively.

21. The Commission finds that, absent actual water consumption information, the Applicant's request to implement metered rates should be denied.

22. Since the Commission has denied the Applicant's proposed metered water rate structure it is incumbent upon the Commission to specify a rate structure that will allow the Applicant the opportunity to generate the revenue requirement recognized in this order. The Commission finds that the Applicant should continue the flat water rate structure presently in effect, and generate the increased revenues authorized herein by application of a uniform percentage increase to all rates and charges.

23. When the Applicant has one year's actual water consumption data available, it can convene a hearing under the provisions of Title 69, Chapter 7, MCA, and implement a metered rate structure to comply with the requirements of the FHA. The Commission encourages the Applicant to convene such a hearing because usage based rates create equity in billing, causing the user receiving the service to pay for the service received.

MISCELLANEOUS

24. During the course of the public hearing it was brought to the Commission's attention that the City of Ronan, as a subscriber to water utility service, was being provided service at no charge.

Section 69-3-305, MCA, prohibits a utility from providing service at no charge to a consumer, even if the consumer is the owner of the utility. Ronan's water utility is an enterprise operation, which means it is a self supporting fund within the local government and should receive compensation from the appropriate City fund account for services rendered. One year from the date of this order the Applicant should start phasing in, over a three year period, the full appropriate charge for the City's connections.

25. The Applicant has never viewed the provision of fire protection as a separate cost center in the operation of its water utility. The provision of fire protection represents a significant cost to the water utility and these costs should be examined and should be recovered through the implementation of a fire hydrant rental fee.

The Applicant's rate proposal includes fire protection cost recovery as a component of the user charges assessed water consumers. This method of recovering costs associated with fire protection is, in the Commission's opinion, inappropriate. Recovery of the fire protection cost through the commodity charges is inequitable because water consumption, on which the monthly rate is based, has no correlation with fire flow requirements of the customer classifications.

Fire flow requirements in a residential section of the City's service area are generally lower than that required in a commercial area, therefore, capital costs associated with fire protection in the residential area should be less than in a commercial area. Since fire flow requirements are lower in a residential than commercial area the peaking factor applicable to allocation of this cost will be lower for a residential area.

As shown in the preceding paragraph, variances exist in the cost of providing fire protection to the various customer classifications. In future proceedings at the local level or before this Commission the City should demonstrate that recovery of fire protection costs consider these variances.

CONCLUSIONS OF LAW

1. The Applicant, the City of Ronan, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates. Title 69, Chapter 7, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

NOW, THEREFORE, IT IS ORDERED THAT:

1. The City of Ronan shall file rate schedules, consistent with the Findings of Fact herein, for its Ronan, Montana service area.

2. The City of Ronan is authorized to issue revenue bonds in the amount of \$1,100,000 with the requirements as outlined in Finding Fact No. 13.

3. The City of Ronan is authorized to file increased rates recognizing operation and maintenance costs and costs associated with the proposed revenue bonds. The rates shall become effective upon Commission approval subsequent to the issuance of the revenue bonds.

4. The rates approved herein shall not become effective until the tariffs, revenue bond ordinance(s), and necessary calculations relating to debt costs have been submitted for review by the Commission.

DONE IN OPEN SESSION at Helena, Montana, this 22nd day of August, 1988, by a 5 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

JOHN B. DRISCOLL, Commissioner

ATTEST:

Carol A. Frasier
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.